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80-881
No. ——

IN THE
Supreme Court of the United States
OCTOBER TERM, 1980

TEMA OIL COMPANY and ASHLAND EXPLORATION, INC.,
Petitioners

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

Does the new standard of review adopted by the Court of Appeals below, which approves agency interpretations that are contrary to the underlying agency regulation, improperly conflict with this Court's established standard which disapproves agency interpretations that are inconsistent with the underlying regulation?

PARTIES TO THE PROCEEDING BELOW

The parties to the original administrative proceedings below were Ashland Oil, Inc., the producer-seller of the natural gas involved herein, Colorado Interstate Gas Company and Cities Service Gas Company, the current pipeline-purchasers of the natural gas involved herein, and the Federal Power Commission. During the pendency of the administrative proceedings, Ashland Exploration, Inc. was substituted for Ashland Oil, Inc., and the Federal Power Commission became the Federal Energy Regulatory Commission. Thereafter, while the case was before the Court of Appeals, Ashland Exploration, Inc. assigned the natural gas producing properties involved herein to Tema Oil Company, a partnership comprised of Tenneco Oil Company (50%) and Mesa Petroleum Co. (50%). Tema Oil Company was an intervenor in the proceeding before the Court of Appeals.

For convenience, Ashland Oil, Inc., Ashland Exploration, Inc., and Tema Oil Company will be collectively referred to herein as "Ashland." In addition, for convenience, the Federal Power Commission and the Federal Energy Regulatory Commission will be collectively referred to herein as "Commission."

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Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners, Tema Oil Company and Ashland Exploration, Inc., respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit entered in this proceeding on September 2, 1980.

OPINIONS BELOW

The opinion of the Court of Appeals has not yet been reported, but is printed in Appendix A. The Commission's unreported "Order Denying Application for Rehearing," issued November 27, 1978, in the proceeding styled "Ashland Exploration, Inc. (Successor to Ashland Oil, Inc.), FERC Gas Rate Schedule Nos. 111 and 150" is printed in Appendix B. The unreported letter order of the Com-

mission dated October 13, 1976, and referenced "BNG 221, Ashland Oil, Inc., FPC Gas Rate Schedule Nos. 111 and 150" is printed in Appendix C.

JURISDICTION

The date and time of entry of the judgment of the Court of Appeals are September 2, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. §§ 717, 717r(b) (1976).

REGULATION INVOLVED

The regulation of the Commission involved herein prescribes a ceiling rate for natural gas sold under so-called "rollover contracts." Such regulation is codified at 18 C.F.R. § 2.56a(a)(5) (1979) and reads as follows:

> Sales of natural gas in interstate commerce for resale may be made at . . . [the national rate for "new" gas], provided the sale is made pursuant to (i) a replacement contract where the sale was formerly made pursuant to a permanent certificate of unlimited duration under such prior contract which expired of its own term[s] on or after January 1, 1973, or pursuant to a contract executed on or after January 1, 1973, where the prior contract expired by its own terms prior to January 1, 1973. . . .

STATEMENT OF THE CASE

This case began with two rate increase filings made by Ashland under a Commission regulation which authorizes the collection of a higher rate for wellhead sales of natural gas where the related gas sales contract has "rolled over," *i.e.*, the gas sales contract has expired and has been replaced with a new one. As explained by the Commission, the purpose of its rollover regulation is twofold.

Area Rates for the Appalachian and Illinois Basin Areas, Opinion No. 639, 48 F.P.C. 1299, 1309-10 (1972), *aff'd sub nom. Shell Oil Company* v. *FPC*, 491 F.2d 82 (5th Cir. 1974); *Just and Reasonable National Rates for Sales of Natural Gas from Wells Commenced on or After January 1, 1973, and New Dedications of Natural Gas to Interstate Commerce On or After January 1, 1973*, Opinion No. 699, 51 F.P.C. 2212 (1974), *aff'd sub nom. Shell Oil Company* v. *FPC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976). First, through its rollover regulation the Commission sought to phase out gradually its prior method of vintaging the regulated price of natural gas on the basis of the date of the gas sales contract. By allowing the price for gas sold under older contracts to increase to the higher price level provided for gas sold under newer contracts as the old contracts expire and are replaced, the Commission sought to avoid possible economic dislocations to consumers that might occur if it were to discontinue its old price vintaging system immediately. Second, through its rollover regulation the Commission also sought to encourage increased exploration and development of natural gas supplies for the interstate market by providing interstate producers with additional revenues through increased rates.

The relevant contractual history surrounding Ashland's two rollover rate increase filings is detailed in the Commission's orders involved herein. (App. at 11a-12a). Briefly stated, Ashland first entered into two separate natural gas sales contracts in the 1940's and 1950's. By their own terms, these two contracts were effective for a fixed period of time. When these two contracts completed their fixed terms, they were supplanted with new contracts which are effective for the remaining life of the related gas producing leases. The new contracts are with purchasers different from those under the expired contracts. In 1976, the two current life-of-lease contracts

were amended to include contractual authority for Ashland to collect the higher rollover rate, and rate increase filings to such higher rate were made.

The Commission rejected Ashland's two rate filings on the asserted ground that its rollover regulation may be interpreted to include a requirement that the purchasers under the expired and replacement contracts must be the same and that Ashland's rate filings do not satisfy this alleged requirement. (App. at 14a-15a, 17a). The Commission has conceded that but for the lack of identity of purchasers under the expired and replacement contracts, Ashland's two rate filings would have been accepted under its rollover regulation. Brief for Respondent at 12, *Ashland Exploration, Inc.* v. *FERC*, D.C. Cir. No. 79-1102 (September 2, 1980).

Focusing upon the language of the rollover regulation, the Court of Appeals found that it "does not explicitly address whether the parties to the original contract and the renewal contract must be the same." (App. at 4a, 7a). Turning on the appropriate standard of review for cases where an agency is interpreting its regulations, the Court of Appeals found that its own case law dictates that "courts owe great deference to the interpretation adopted by the agency and will uphold that interpretation if it is reasonable and *consistent with the regulation.*" (App. at 6a; emphasis supplied). The Court of Appeals also found that this standard of review is in harmony with the standard established by this Court which provides that "an agency's interpretation is ' " of controlling weight unless it is plainly erroneous or *inconsistent with the regulation.*" ' " (App. at 7a; emphasis supplied) (citing *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965) and quoting *Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 413-14 (1945)).

However, when it came time to apply the established standard of review adopted by both this Court and the

Court of Appeals, itself, it declined to do so. Instead, the Court of Appeals departed from the established standard stating:

> To bolster its cause, petitioner contends that the Commission's interpretation of its rollover rule is not consistent with its stated policy objectives. This argument, however, *misconstrues the scope of our review*, which begins from the premise that a " 'presumption of validity . . . attaches to each exercise of the Commission's expertise.' " For this reason, only if the Commission's interpretation were so at odds with its stated policy objectives as to render its determination *irrational* would this court set that order aside. (App. at 8a; emphasis supplied; citations omitted).

Thus, whereas this Court's standard of review provides that an agency interpretation cannot be sustained if it is found to be inconsistent with the underlying regulation, the Court of Appeals' standard of review conflicts with such standard by providing that a finding of inconsistency alone is not sufficient. Instead, under the standard of review adopted by the Court of Appeals, the agency interpretation must also be shown to be "irrational" before it will be overturned.

There is no precedent for the lower Courts' novel standard for judicial review of agency interpretations. No case law supports the Court of Appeals' new "irrational" standard for review. This is recognized by the Court of Appeals' own use of a "See" citation. (App. at 8a). Moreover, the "irrational" standard for review is not authorized by the "arbitrary and capricious" standard of the Administrative Procedure Act, 5 U.S.C. §§ 551, 706 (1977), or the "substantial evidence" standard of the Natural Gas Act, 15 U.S.C. § 717r(b).

In the context of this case, the departure by the Court of Appeals from the established standard of review has

resulted in the affirmance of an agency interpretation which is inconsistent with the underlying regulation. The Commission's interpretation provides that an existing purchaser of gas is required to pay a new, higher price for its continued purchase of such gas, while an entirely new purchaser of the same gas is authorized to purchase it at the old, lower price. Such affirmed interpretation is inconsistent with the express goal of the rollover regulation to avoid economic dislocations to gas consumers while phasing out gas price vintaging. *Area Rates for the Appalachian and Illinois Basin Areas*, 48 F.P.C. at 1309-10. In addition, the Commission's interpretation imposes a rate reduction where there is a change in purchasers, although it was only through the change in purchasers that Ashland's gas was switched from the intrastate market to the interstate market. (App. at 11a). Such affirmed interpretation is inconsistent with the second express goal of the rollover regulation to increase the amount of gas supplies available to the interstate market. *Just and Reasonable National Rates* (Opinion No. 699), 51 F.P.C. at 2274-75. In the context of other future agency interpretation cases, application of the Court of Appeals' new standard of review will result in interpretations, which are also shown to be inconsistent with the underlying regulation, being sustained because the interpretations are not themselves "irrational."

REASONS FOR GRANTING CERTIORARI

Regulatory agencies continue to play an increasingly important role in making important economic and social decisions. *See*, American Bar Association, Commission on Law and the Economy, *Federal Regulation: Roads to Reform*, pp. 5-6 (1979). In arriving at these decisions, such agencies increasingly use rulemaking procedures, in lieu of adjudicatory procedures, as their decision-making vehicle. Kenneth Culp Davis, *Administrative Law Treatise*, pp. 448-449, (2nd ed., 1978). Thus, maintenance of

an established, uniform standard of review for cases where, as here, an agency's interpretation of its own rules is at issue becomes extremely important.

In the case at hand, the United States Court of Appeals for the District of Columbia Circuit, which has, by statute, venue to review more agency orders than any other circuit, [*See* Legal Times of Washington, *D.C. Circuit Handbook*, pp. 3 and 7 (Diana Hoffman ed., 1980).[1]] departed from the standard of review established by this Court. The Court of Appeals' new standard, if permitted to stand, allows agency interpretations to be sustained even though they are inconsistent with the underlying regulations if the interpretations are themselves not irrational. Thus, there coalesce in this case the increasing importance of agency interpretations and a significant departure by the Court of Appeals generally charged with supervising such agencies from the standard of review established by this Court for such interpretations.

A. The Court of Appeals' new standard of review conflicts with the standard of review established by this Court.

There is no dispute regarding the established standard of review for cases involving agency interpretations. As found by the Court of Appeals. (App. at 7a), the standard established by this Court provides that "the agency's interpretation is '"of controlling weight unless it is

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[1] See, for example, Federal Aviation Act of 1958, 49 U.S.C. § 1301, *et seq.* (1976), 49 U.S.C. § 1486(b); Federal Credit Union Act, 12 U.S.C. § 1751, *et seq.* (1980), 12 U.S.C. § 1786(i)(2); Federal Food, Drug & Cosmetics Act, 21 U.S.C. § 301, *et seq.* (1972), 21 U.S.C. § 355(h); Federal Power Act, 16 U.S.C. § 791a, *et seq.* (1974), 16 U.S.C. § 8251; Natural Gas Act, 15 U.S.C. § 717, *et seq.* (1976), 15 U.S.C. § 717r(b); Occupational Safety and Health Act of 1970, 29 U.S.C. § 651, *et seq.* (1975), 29 U.S.C. § 660(a); Securities Act of 1933, 15 U.S.C. § 77a, *et seq.* (1971), 15 U.S.C. § 77i(a).

plainly erroneous or *inconsistent with the regulation.*" ' *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965) (quoting *Bowles* v. *Seminole Rock Co.*, 325 U.S. 410, 413-14 (1945))." (Emphasis supplied). However, the Court of Appeals declined to apply such established standard. (App. at 8a). Instead, the Court of Appeals adopted a new standard which provides that only if the agency's interpretation is "so at odds with its stated policy objectives as to render its determination irrational would . . . [the Court of Appeals] set that order aside." (App. at 8a). Thus, the Court of Appeals has adopted a new standard of review which conflicts with this Court's established standard since it approves agency interpretations which are inconsistent with the underlying regulations if the interpretations are not themselves irrational.

B. The Court of Appeals' new standard of review is not appropriate for agency interpretation cases because it confuses interpretations and amendments.

There are significant differences between an interpretation of an agency regulation and an amendment of an agency regulation which must be recognized in a proper standard for judicial review. Where an agency is truly interpreting a regulation, the notice and other procedural requirements of the Administrative Procedure Act do not apply. *Standard Oil Co.* v. *DOE*, 596 F.2d 1029, 1056 (TECA 1978). This is so because in interpreting a regulation, the agency is not promulgating a new requirement, but instead is merely embellishing upon an existing requirement as to which all are already on notice. *National Helium Corp.* v. *FEA*, 569 F.2d 1137, 1145-46 (TECA 1977). Thus, as provided by this Court's established standard of review, the test for the propriety of an interpretation is whether it is consistent with the underlying regulation. In deciding this question, the irrationality *vel non* of the interpretation, itself, may be relevant, but it cannot be controlling. Certainly, an agency order may

be rational on its face, but yet not be consistent with the underlying regulation. The converse would not appear to be true.

On the other hand, an agency order which may be rational on its face, but which is inconsistent with the underlying regulation, is not an interpretation, but rather an amendment to the underlying regulation. For example, an agency order may be deemed to be rational because it achieves a proper and desirable result even though the order is totally at odds with the agency's regulations.[2] In such circumstances, the agency is amending, rather than interpreting its regulations. Importantly, unlike an interpretation, an amendment is subject to the notice and other procedural requirements of the Administrative Procedure Act. *Detroit Edison Co.* v. *EPA*, 496 F.2d 244 (6th Cir. 1974). This is so because, unlike an interpretation, an amendment imposes a new requirement rather than merely embellishing upon an existing one. Moreover, because an amendment does impose a new requirement, an amendment generally cannot be applied retroactively. *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1974). However, the Court of Appeals' new standard does violence to both of these limitations on the application of an amendment.

By allowing agencies to implement "interpretations" which are inconsistent with the underlying regulation on the grounds that the "interpretation" is not itself irrational, the Court of Appeals effectively permits agencies

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[2] Ashland in no way agrees that the identity-of-purchaser requirement is rational. To the contrary, Ashland maintains that it is irrational to require an existing purchaser of gas to pay a higher price to continue to purchase such gas while at the same time allowing an entirely new purchaser to acquire the same gas at a lower price. Such irrationality is particularly acute where the new requirement is adopted in conjunction with a regulation which was designed to allow higher prices without causing economic dislocations to gas consumers.

to amend their regulations without complying with the requirements of the Administrative Procedure Act. Moreover, by confusing amendments with interpretations, the Court of Appeals' new standard improperly allows agencies to impose an amendment retroactively in the case where the "interpretation" is promulgated. Thus, the Court of Appeals' new standard cannot be permitted to stand because by confusing interpretations and amendments it improperly permits circumvention both of the Administrative Procedure Act and of the prohibition against retroactivity.

Here, by affirming an amendment in the name of an interpretation, the Court of Appeals has allowed the Commission to perpetrate such a circumvention. The Court of Appeals expressly found that the language of the Commission's rollover regulation does not include the alleged identity-of-purchaser requirement. (App. at 7a). Thus, no provision of the rollover regulation contains any suggestion that an identity-of-purchaser requirement might exist. Consequently, by applying its new standard of review the Court of Appeals has improperly allowed the Commission both to amend its rollover regulation without requiring compliance with the Administrative Procedure Act and to enforce such amendment retroactively in the case where it was first promulgated.

C. The Court of Appeals' new standard is unworkable.

The Court of Appeals' new standard of review provides that an agency interpretation will be sustained unless it is shown to be "irrational." Webster's Unabridged Dictionary defines the term "irrational" to mean "not endowed with reason." *Websters Third New International Dictionary of the English Language* (Unabridged) (P.B. Gove ed., 1966). Application of this standard requires the reviewing court to undertake an analysis of the mental processes underlying the agency's action. In undertaking such an analysis, the reviewing court is not

provided with an objective standard against which to measure the agency's action. Rather, the reviewing court is required to measure the agency's action against its own subjective opinion as to whether the agency's action is endowed with reason. In essence, the reviewing court is required to determine whether the court would have reached the same conclusion itself. But, courts have historically declined to decide agency cases on the basis of whether the court would have independently reached the same conclusion as the agency did. *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 416 (1971).

In marked contrast, this Court's established standard calls for an objective, rather than a subjective, analysis. In determining whether an agency interpretation is consistent with the underlying regulation, the reviewing court is required to use the underlying regulation as its benchmark against which to measure the interpretation's consistency. The reviewing court does not merely decide whether, in its subjective opinion, the agency's interpretation is irrational.

Moreover, a standard of review which requires a showing of "irrationality" imposes an impossible burden of proof. To satisfy it, the petitioner is required to prove the negative, *i.e.*, that the agency's interpretation is devoid of reason. In addition, the petitioner is forced to elect at its peril what proof of irrationality is required to satisfy the subjective judgment of the particular reviewing court that is involved. Clearly, use of such a nebulous standard effectively results in the rubber stamping of agency interpretations, and thus renders judicial review of agency interpretations a nullity.

Here, application of the Court of Appeals' new standard for review effectively nullified judicial review. The Court of Appeals found that "no identity-of-purchaser requirement is included in the language of the rule itself." (App. at 7a). The Court of Appeals also found "plaus-

ible" Ashland's contention that an identity-of-purchaser requirement is not required in order for the rollover regulation to satisfy its two goals of phasing out gas price vintaging and encouraging greater exploration and development of interstate supplies. (App. at 7a-8a). Finally, the Court of Appeals did not refute Ashland's contention that the Commission's interpretation is inconsistent with the rollover regulation but instead asserted that Ashland's argument "misconstrues the scope of our review." (App. at 8a). It is submitted that, had the Court of Appeals properly applied this Court's established standard, rather than its novel "irrational" standard, the foregoing analysis of the case by the Court of Appeals would have resulted in a reversal rather than an affirmance.

CONCLUSION

This case involves the adoption by the D.C. Circuit of a new standard for review of agency interpretations that is in conflict with this Court's long established standard of review. Because of its imprecision, the Court of Appeals' new standard permits agencies to implement amendments to regulations in the guise of interpretations, thus circumventing the requirements and limitations of the Administrative Procedure Act. Because of its imprecision, the Court of Appeals' new standard is also unworkable. Thus, it is requested that a writ of certiorari be granted in this case.

Respectfully submitted,

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Appendices

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 79-1102

ASHLAND EXPLORATION, INC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

Petition for review of an Order of the
Federal Energy Regulatory Commission

Argued May 12, 1980

Decided September 2, 1980

Bernard A. Foster, III with whom *Phyllis C. Rainey*, for Intervenor, Tema Oil Company and *Richard F. Generelly* for petitioner, Ashland Exploration were on the brief and presented argument for both parties. *John H. Burnes, Jr.* also entered an appearance for petitioner.

Kristina Nygaard, Attorney, Federal Energy Regulatory Commission, for respondent.

Henry F. Brown also entered an appearance for Intervenor, Colorado Interstate Gas Company.

Alfred O. Hall and *John H. Cary* also entered appearances for Intervenor, Cities Service Gas Company.

Before: TAMM and MIKVA, *Circuit Judges*, and GESELL, *United States District Court Judge* for the District of Columbia.

Opinion Per Curiam.

PER CURIAM: In the argot of natural gas regulation, a contract for the sale of natural gas "rolls over" when it expires and is replaced by another contract for the same supply of gas. Under current regulations of the Federal Energy Regulatory Commission (FERC), 18 C.F.R. § 2.56a(a)(5) (1979), sellers of flowing natural gas may charge higher rates if the gas is sold under a contract that has "rolled over" on or after the specified date of January 1, 1973. The Commission's current rollover rule has already been approved by this court, *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016, 1057-61 (D.C. Cir. 1977), *cert. denied* 435 U.S. 907 (1978), and the only issue to be decided here concerns how it should be applied. The Commission, in this case, denied the benefit of rollover treatment to petitioner Ashland Exploration, Inc. (Ashland) on the ground that the contracts in question did not qualify under the terms of the regulation as construed by the Commission. Because the Commission's interpretation of its own regulation is clearly within reasonable bounds, its order is affirmed.

I. BACKGROUND

A. *Regulatory Context*

For some time before promulgating the regulation at issue here, the Commission had operated a two-tier pricing system for natural gas sold in interstate commerce. Under that system, the maximum price for which regulated gas could be sold depended on its "vintage." Gas sold pursuant to a contract entered into *before* a specified "division date" was "old" and was distinguished for regulatory purposes from gas that had not been

sold in the interstate market until *after* the specified "division date." That gas was regarded as "new." The ceiling price for "new" gas was higher than that for "old" gas, presumably to cover the higher production cost and to encourage new exploration.

In time, the Commission came to be dissatisfied with its two-tier system because it was not providing sufficient economic incentives to assure adequate supply. Accordingly, the Commission embarked on a new course, intended to phase out vintaging by allowing "old" gas to qualify for the higher ceiling price afforded "new" gas when the original "old"-gas contract "rolled over." Between 1972 and 1976, this new policy was successively refined.[1] The ultimate rollover rule, now codified at 18 C.F.R. § 2.56a(a)(5) (1979), reads as follows:

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[1] The Commission's rollover rule was formulated and successively reformulated in the following three opinions:

(1) Opinion No. 639, *Area Rates for Appalachian and Illinois Basin Areas*, 48 F.P.C. 1299 (1972), *reh. denied*, Opinion No. 639-A, 49 F.P.C. 361 (1973), aff'd sub nom. *Shell Oil Co.* v. *FPC*, 491 F.2d 82 (5th Cir. 1974);

(2) Opinion No. 699, *Just and Reasonable National Rates for Sales of Natural Gas*, 51 F.P.C. 2212, *modified*, Opinion No. 699-A, 52 F.P.C. 263, *modified*, Opinion No. 699-H, 52 F.P.C. 1604 (1974), *aff'd sub nom. Shell Oil Co.* v. *FPC*, 520 F. 2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976);
(3) Opinion No. 770, *Uniform National Rates for Sales of Natural Gas*, Docket No. RM75-14, 10 F.P.S. 5-293 (July 27, 1976), *modified*, Opinion No. 770-A, 10 F.P.S. 5-854 (Nov. 5, 1976), *aff'd sub nom. American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978).

In its most recent promulgation of the national rate for natural gas—Opinions 770 & 770A, *supra* (codified at 18 C.F.R. § 2.56(a)(1979))—three different rates were established: one for sales from wells begun after January 1, 1975; a lower rate for gas dedicated to the interstate market between January 1, 1973 and December 31, 1974; and a lower rate still for gas sales pursuant

> Sales of natural gas in interstate commerce for resale may be made at [the national rate for "new" gas], provided the sale is made pursuant to (i) a replacement contract where the sale was formerly made pursuant to a permanent certificate of unlimited duration under such prior contract which expired by its own term [*sic*] on or after January 1, 1973, or pursuant to a contract executed on or after January 1, 1973, where the prior contract expired by its own terms prior to January 1, 1973. . . .

Except for slight variations in wording not relevant here, this rule was in effect throughout the proceedings now under review.

As currently formulated, the rollover rule assumes that there is an original contract and a renewal contract which "replaces" it. If the original contract expires of its own terms before the cutoff date and is replaced by a renewal contract executed after the cutoff date or, alternatively, if the original contract expires of its own terms after the cutoff date (irrespective of when its replacement contract is executed), the higher, "new"-gas ceiling applies. The rollover rule, however, comes into play only when the original contract is of a fixed term. If the original contract is of an indeterminate duration—*e.g.*, for as long as production from a given well is profitable—it will never be eligible for the "new"-gas rate. *See Austral Oil Co.* v. *FPC*, 560 F.2d 1262, 1267 (5th Cir. 1977).

The rollover rule as finally formulated does not explicitly address whether the parties to the original contract and the renewal contract must be the same. That is the nub of the current dispute.

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to contracts that rolled over on or after January 1, 1973. It is only the third and lowest national rate that is applicable in this case. For the purposes of this opinion, therefore, the distinction between three vintages of "new" gas may be ignored.

B. *The Contested Filings*

At issue here are two proposed rate increases filed by Ashland pursuant to the Commission's rollover rule. Although the particulars of each of the two filings differ, the general fact pattern is the same: Ashland's corporate predecessor entered into a fixed-term contract for sale of natural gas with an initial buyer. That contract expired of its own terms and was supplanted by a life-of-lease contract with a different buyer—all long before January 1, 1973. In the spring of 1976, Ashland and the second buyer modified the then-operative life-of-lease contract to permit rate increases up to the applicable national rate ceiling. Shortly after that, Ashland filed its proposed rate increase with the Commission claiming that rate increases were warranted under the rollover rule.[2]

In a letter order dated October 13, 1976, the Commission rejected these rate filings because "the original contracts *with the current purchasers* [had] not expired." Joint Appendix (J.A.) at 104 (emphasis added). Although acknowledging that the current contracts superceded fixed-term contracts that had expired of their own terms, the Commission said that this was "of no significance" because those contracts had "covered sales to different buyers." *Id.* Therefore, the Commission concluded, the proposed rate increases were "not acceptable under the vintaging concepts" it had previously established. *Id.*

On consideration of Ashland's petition for rehearing, the Commission reaffirmed its earlier order. It noted that the rollover rule as initially formulated in 1972 spoke of

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[2] The specifics of these two transactions are set forth in the Commission's unpublished order *Ashland Exploration, Inc.*, FERC Gas Rate Schedules Nos. 111 and 150 (Nov. 27, 1978), *reprinted in* Joint Appendix at 110.

"the 'purchaser and seller' entering into a new contract" to replace the original fixed-term contract. J.A. at 114. Thus, the Commission explained, the rollover policy was always intended to apply only when the seller has renewed a gas-sale contract with the same buyer. Reading an identity-of-purchaser qualification into the current version of the rule, the Commission concluded that the "original contracts" for rollover purposes in this case were the life-of-lease contracts with the second buyers. Because those contracts were not of a fixed term, the rollover rule did not apply.[3]

II. The Propriety of the Commission's Interpretation

It is a basic tenet of administrative law that administrative agencies are entitled to wide latitude in interpreting their own regulations. As this court has recently said:

> When construction of an agency regulation is in issue, courts owe great deference to the interpretation adopted by the agency and will uphold that interpretation if it is reasonable and consistent with the regulation. The court need not find that the agency's construction is the only possible one, or

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[3] The Commission may have misspoken when it said that life-of-lease contracts are "*never* entitled to rollover treatment." J.A. at 115 (emphasis added). It seems that the Commission does afford rollover treatment to life-of-lease contracts *if* they replace contracts of a fixed term. *See* Brief for Respondent FERC at 11. We assume, therefore, that the Commission meant only to note that a life-of-lease contract preceded by a fixed-term contract with different parties is no more entitled to rollover treatment than if it had not been preceded by a fixed-term contract at all. The authority of the Commission to exclude from rollover treatment contracts that were initially of an indeterminate term has previously been upheld. *Austral Oil Co.* v. *FPC*, 560 F.2d 1262 (5th Cir. 1977).

> even the one that the court would have adopted in the first instance.

Belco Petroleum Corp. v. *FERC*, 589 F.2d 680, 685 (D.C. Cir. 1978). As a general rule, the agency's interpretation is " 'of controlling weight unless it is plainly erroneous or inconsistent with the regulation.' " *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965) (quoting *Bowles* v. *Seminole Rock Co.*, 325 U.S. 410, 413-14 (1945)).

This is not the first time a Commission interpretation of its rollover rule has been challenged in court. In *Austral Oil Co.* v. *FPC*, 560 F.2d 1262 (5th Cir. 1977), the parties to a gas-sale contract that was originally open-ended agreed to a modification fixing an exact termination date. When the modified contract expired, rollover treatment was sought. The Commission concluded that rollover treatment was not proper because the contract *as originally written* was not of a fixed term. Even though the rule did not say that the original contract *as originally written* must be of a fixed term, the Commission's decision was sustained. The analogous result is mandated here.

In the case under review, the Commission interpreted its rollover rule as applying only when the purchaser under the original fixed-term contract and the purchaser under the replacement contract are the same. Objecting to this interpretation, the petitioner insists that no identity-of-purchaser requirement is included in the language of the rule itself. This is true but beside the point.

Under the petitioner's proffered interpretation of the rule, a subsequent contract "replaces" an earlier one if it is for sale of gas from the same acreage even though the purchasers may differ. But the Commission says a subsequent contract does not "replace" an earlier one unless the buyers and sellers are the same. The petitioner's interpretation of the rollover rule is plausible

but not any more so than the Commission's. That being so, the Commission's interpretation must prevail. No matter how carefully an administrative rule is drawn, novel applications will be sought. The agency need not construe an ambiguous regulation in the way most favorable to an applicant.

To bolster its cause, petitioner contends that the Commission's interpretation of its rollover rule is not consistent with its stated policy objectives. This argument, however, misconstrues the scope of our review, which begins from the premise that a " 'presumption of validity . . . attaches to each exercise of the Commission's expertise.' " *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 307 (1974) (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968)). For this reason, only if the Commission's interpretation were so at odds with its stated policy objectives as to render its determination irrational would this court set that order aside. *See Superior Oil Co.* v. *FERC*, 563 F.2d 191, 201-02 (5th Cir. 1977); *Transcontinental Gas Pipe Line Corp.* v. *FPC*, 518 F.2d 459, 465 (D.C. Cir. 1975); *Public Service Comm'n* v. *FPC*, 543 F.2d 757, 782 (D.C. Cir. 1974).

In developing its rollover policy, the Commission was striving for two goals: first, the eventual elimination of all vintaging and, second, the amelioration of economic dislocations caused by that change.[4] Accordingly, the Commission chose as its policy that vintaging be phased out, not eliminated immediately. This path between competing policy objectives—as one of those " 'pragmatic adjustments which may be called for by particular circumstances,' " *Permian Basin Area Rates Cases*, *supra*, 390 U.S. at 777 (quoting *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942))—is clearly within the

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[4] *See* Opinion No. 770A, *supra* note 1, 10 F.P.S. at 5-873 to -875, slip op. at 20-21; Opinion No. 770, *supra* note 1, 10 F.P.S. at 5-301 to -305, slip op. at 12-16; Opinion No. 699-H, *supra* note 1, 52 F.P.C. at 1637-38 & n.118.

province of the Commission, which "'must be free . . . to devise methods of regulation capable of equitably reconciling diverse and conflicting interests,'" *Mobil Oil Corp.* v. *FPC*, *supra*, 417 U.S. at 331 (quoting *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 767). The current regulation, which affords rollover treatment to fixed-term contracts but not those of an indeterminate term, is one way the Commission can carry out its policy. *Austral Oil*, *supra*, 560 F.2d at 1265-66; *cf. American Public Gas Ass'n* v. *FPC*, *supra*, 567 F.2d at 1061 n.91 (upholding Commission's denial of rollover benefit to indefinite term contracts in effect for 20 or more years). Having made that initial policy choice, the Commission may employ any regulatory interpretation conducive to its achievement. *Austral Oil*, *supra*, 560 F.2d at 1266.

If it had allowed life-of-lease contracts preceded by fixed-term contracts with other parties to qualify for rollover treatment, the Commission would have increased the number of contracts qualifying for the higher ceiling rate. This would have hastened the phase out of vintaging but, for that very reason, would have increased those economic dislocations to consumers that the Commission sought to ameliorate. It was not irrational for the Commission to decline to pursue this course. Accordingly, the petitioner's policy-related argument is without merit.

We have considered the other arguments advanced by petitioner and find them equally unpersuasive. For the foregoing reasons, the Commission's order is

Affirmed.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

REPLACEMENT CONTRACT POLICY
(Rollover Contracts)

Before Commissioners:

Charles B. Curtis, Chairman; Don S. Smith, and Georgiana Sheldon.

ASHLAND EXPLORATION, INC.

(Successor to Ashland Oil, Inc.)

FERC GAS RATE SCHEDULES

Nos. 111 and 150

ORDER DENYING APPLICATION FOR REHEARING

(Issued November 27, 1978)

On November 12, 1976, Ashland [1] filed an application for rehearing and reconsideration of the Commission's [2] letter order issued October 13, 1976, rejecting proposed rate increases in Ashland's FERC Gas Rate Schedules Nos. 111 and 150 filed September 13 and 20, 1976, respectively. Rate Schedule No. 111 covers sales

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[1] Effective October 1, 1976, Ashland Oil Inc. transferred, *inter alia*, its contract relative to the gas sales involved herein to its wholly owned subsidiary, Ashland Exploration, Inc. As used herein, the term "Ashland" shall mean either company, as indicated by the context.

[2] This proceeding was commenced before the FPC. By the joint regulation of October 1, 1977 (10 CFR 1000.1), it was transferred to the FERC. The term "Commission" when used in the context of action taken prior to October 1, 1977, refers to the FPC; when used otherwise, the reference is to the FERC.

to Cities Service Gas Company (Cities) and Rate Schedule No. 150 covers sales to Colorado Interstate Gas Company (CIG). The increases were to the 52.0 cents per Mcf base rate applicable to replacement ("rollover") contracts in 1976 under 18 CFR 2.56a(a)(5).[3] On December 10, 1976, the Commission granted Ashland's application for rehearing solely for purposes of further consideration.

Ashland Rate Schedule No. 111. On December 21, 1942, United Producing Company, Inc. (UPC), Ashland's predecessor in interest in Rate Schedule No. 111, entered into a five year contract with its parent company, United Carbon Company (UCC) to supply gas to UCC's carbon black plant in Ryus, Kansas. This intrastate sale was terminated by a new contract entered into by UPC and UCC on December 1, 1947, which had a primary term of 15 years and committed additional acreage to UCC for its carbon plant. On March 12, 1948, UPC entered into a life-of-lease contract with Cities for the sale of gas in excess of UCC's plant requirements and gas which was to be available after the December 1, 1947 contract expired. Ashland (as successor to UPC) and Cities amended the March 12, 1948 contract by an agreement dated April 12, 1976, to permit rate increases up to the applicable national rate ceiling.

Ashland Rate Schedule No. 150. Here we are concerned with gas which was originally sold by Ashland's predecessor, UPC, to CIG pursuant to a contract dated July 1, 1952, which contained a life-of-lease provision. This contract, along with two others between UPC and CIG not involved with matters covered in this order,[4]

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[3] From Opinion No. 770 (national rates biennial review) issued July 27, 1976, as amended by Opinion No. 770-A, issued November 5, 1976.

[4] These two contracts have previously been accorded rollover contract rates.

were merged with a single life-of-lease contract between Ashland and CIG dated August 30, 1957. Prior to the July 1, 1952 contract, gas from some of the acreage dedicated thereunder was sold by UPC to Cities pursuant to a letter agreement dated August 21, 1951.[5] The sale was for six months, terminable thereafter by either party upon 30 days notice. Ashland and CIG amended the August 30, 1957 contract by an agreement dated May 27, 1976, to permit rate increases up to the applicable area rate ceiling.

Both CIG and Cities filed petitions to intervene herein. CIG stated no position. Cities pointed out that in its opinion its March 12, 1948 life-of-lease contract with Ashland has not expired, although it agrees with Ashland that such contract was amended on April 12, 1976, to provide for the national rate.

Ashland seeks to justify its proposed increases under the above rate schedules on the basis that the original contracts for the sales of gas involved herein under these rate schedules expired of their own terms prior to January 1, 1973, and that new replacement contracts were entered into after January 1, 1973. The original contracts to which Ashland refers apparently are the December 21, 1942, and the December 1, 1947 contracts between UPC and UCC (gas presently dedicated for sale under Ashland's Rate Schedule No. 111) and the six months' contract between UPC and Cities dated August 21, 1951 (gas presently dedicated for sale under Ashland's Rate Schedule No. 150).

The pertinent portion of Opinion No. 770-A reads as follows:

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[5] This sale was not required to be certificated because it terminated prior to June 7, 1954, the date the FPC began regulation of producer rates pursuant to *Phillips Petroleum Corporation* v. *Wisconsin Pipeline Company*, 347 U.S. 672.

> (a) (5) Sales of natural gas in interstate commerce for resale may be made at a rate of 52 cents per Mcf (at 14.73 psia), exclusive of all State or Federal production, severance or similar taxes, and subject to the adjustments provided in this Section 2.56a, and the escalation provided in subsection (a) (6), provided the sale is made pursuant to (A) a replacement contract where the sale was formerly made pursuant to a permanent certificate of unlimited duration under such prior contract which expired by its own term on or after January 1, 1973, or *pursuant to a contract executed on or after January 1, 1973, where the prior contract expired by its own terms prior* to January 1, 1973; . . . [Emphasis supplied.]

The Commision ruled in its letter order issued October 13, 1976, as follows:

> The sales involved herein do not meet the criteria to qualify for the national rate because the original contracts with the current purchasers have not expired. The fact that the original contracts covering sales from these properties have expired is of no significance here because such contracts covered sales to different buyers, one of which was in intrastate commerce. Accordingly, your proposed notices of change in rate are not acceptable under the vintaging concepts established in Opinion No. 639 and are hereby rejected. . . .

Ashland excepts to this ruling on the ground that by the plain meaning of Paragraph A(a) (5) of Opinion No. 770-A there is no requirement that the purchasers be the same in order for the replacement contract policy to apply.

The replacement contract policy had its genesis in Opinion No. 639, *Area Rates for the Appalachian and*

Illinois Basin Areas, 48 FPC 1299 (1972). The precise language creating the policy appears at page 1310 and reads in pertinent part as follows:

> The wording of Order No. 411, and all other Commission area rate orders or opinions of similar import, stating that "old" gas rates will be applicable to "gas sold pursuant to a contract dated prior to October 8, 1969" will be literally and strictly applied. If a gas contract dated prior to October 8, 1969, terminates, *and the purchaser and seller enter into a new contract*, gas sales under the new contract will be governed by the applicable pricing provisions relating to "gas sold pursuant to a contract dated after October 7, 1969." We will, thereby, simply adhere to the plain meaning of Order No. 411, and other orders and opinions with similar language, as written. . . . [Emphasis added.]

In our opinion, this language precludes predicating operation of the replacement contract policy on the existence of expired previous contracts for sale of the gas involved under the fact situations of the case at bar. The prior contracts relied on by Ashland were with other parties than Ashland's present purchasers Cities and CIG, whereas Opinion No. 639 (underlined portion above) speaks of the "purchaser and seller" entering into a new contract. The context makes it clear that this has reference to the same parties, or their successors, who were purchaser and seller under the prior contract. Consequently, the Commission's rollover policy has no applicability to those sales made to a purchaser other than the current purchaser, and thus the December 21, 1942, or the December 1, 1947 contracts between UPC and UCC and the August 21, 1951 letter agreement between UPC and Cities are irrelevant. As a result, for rollover purposes the original contracts here are the March 12, 1948 life-of-lease contract between UPC and Cities (Ash-

land's Rate Schedule No. 111) and UPC's life-of-lease contract with CIG (Ashland's Rate Schedule No. 150). In view of the life-of-lease nature of these contracts, they are never entitled to rollover treatment. *Austral Oil Company, Inc* v. *FPC*, 560 F.2d 1262 (1977).

Accordingly, our letter order of October 13, 1976, properly rejected Ashland's rate increases.

CIG's and Cities' petitions to intervene are found to be in the public interest and will be granted.

The Commission finds:

Ashland's application for rehearing presents no new facts or principles of law which warrant any modification of our October 13, 1976 order.

The Commission orders:

(A) Ashland Oil, Inc.'s application for rehearing filed herein November 12, 1976, is hereby denied.

(B) Colorado Interstate Gas Company and Cities Service Gas Company are permitted to intervene herein subject to the rules and regulations of the Commission; *Provided, however*, that the participation of such intervenors shall be limited to matters affecting asserted rights and interests as specifically set forth in their petitions to intervene; and *Provided, further*, that the admission of such intervenors shall not be construed as recognition by the Commission that they might be aggrieved because of any order of the Commission entered in this proceeding.

By the Commission.

(SEAL)

Kenneth F. Plumb,
Secretary.

APPENDIX C

FEDERAL POWER COMMISSION
WASHINGTON, D.C. 20426

In reply refer to:
BNG 221
Ashland Oil, Inc.
FPC Gas Rate Schedule Nos. 111
and 150

Gas Corres.

[Oct. 13, 1976]

Ashland Oil, Inc.
P.O. Box 1503
Houston, Texas 77001

Attention: Ben G. Price, Supervisor
Contract Administration

Gentlemen:

This is with reference to the notices of change in rate filed September 13, 1976, and September 20, 1976, as proposed supplements to your company's FPC Gas Rate Schedule Nos. 111 and 150, respectively.

Opinion No. 699, as amended, permits collection of the national rate for new gas under a replacement contract where the sales were formerly made pursuant to permanent certificates of unlimited duration under prior contracts which expired of their own terms on or after January 1, 1973; or pursuant to a contract executed on or after January 1, 1973, which replaced a contract which had expired by its own terms prior to January 1, 1973.

The gas now being sold to Cities Service Gas Company under Ashland's Rate Schedule No. 111 was pre-

viously sold intrastate to United Carbon Company pursuant to two contracts dated December 21, 1942, and December 1, 1947, which had contract terms of five and fifteen years, respectively. The gas is now being sold to Cities Service Gas Company under a life-of-lease contract dated March 12, 1948, pursuant to a certificate in Docket No. G-3912.

Part of the gas now being sold to Colorado Interstate Gas Company under Ashland's Rate Schedule No. 150 was previously sold to Cities under a contract dated July 1, 1952, with a six month contract term. This sale was never certificated. The sale is now being sold to Colorado under a life-of-lease contract dated August 30, 1957, pursuant to a certificate in Docket No. G-3912.

The sales involved herein do not meet the criteria to qualify for the national rate because the original contracts with the current purchasers have not expired. The fact that the original contracts covering sales from these properties have expired is of no significance here because such contracts covered sales to different buyers, one of which was in intrastate commerce. Accordingly, your proposed notices of change in rate are not acceptable under the vintaging concepts established in Opinion No. 639 and are hereby rejected. Such filings are being retained in the Commission's files for informational purposes.

By direction of the Commission.

Secretary

cc: Colorado Interstate Gas Company
P.O. Box 1087
Colorado Springs, Colorado 80901

Cities Service Gas Company
P.O. Box 25128
Oklahoma City, Oklahoma 73125